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Reporting the results of operations. I. Net income and the treatment of extraordinary items and prior period adjustments. II. Computation and reporting of earnings per share ; Opinions of the Accounting Principles Board 09;APB Opinion 09;

American Institute of Certified Public Accountants. Accounting Principles Board

OPINIONS OF THE ACCOUNTING PRINCIPLES BOARD

DECEMBER 1966

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Reporting the Results of Operations

I — Net Income and the Treatment of Extraordinary Items and Prior Period Adjustments

II — Computation and Reporting of Earnings Per Share

CONTENTS

Issued by the Accounting Principles Board of the American Institute of Certified Public Accountants

INTRODUCTION

1. The American Institute of Certified Public Accountants, through its boards and committees, reviews from time to time the form and content of financial statements to determine how their usefulness may be improved. This Opinion is the result of a review of present practice in the reporting of the results of operations of business entities.

2. This Opinion supersedes (a) Chapter 2B, *Combined Statement of Income and Earned Surplus* of Accounting Research Bulletin No. 43; (b) Chapter 8, *Income and Earned Surplus* of Accounting Research Bulletin No. 43; and (c) Accounting Research Bulletin No. 49, *Earnings per Share.* It also modifies Chapter 5, *Intangible Assets* (paragraphs 5, 6, 8 and 9); Chapter 10A, *Real and Personal Property Taxes* (paragraph 19); Chapter 10B, *Income Taxes* (paragraphs 15 and 17); Chapter 11B, *Government Contracts – Renegotiation* (paragraph 9); Chapter 12, *Foreign Operations and Foreign Exchange* (paragraph 21); and Chapter 15, *Unamortized Discount, Issue Cost, and Redemption Premium on Bonds Refunded* (paragraphs 7 and 17) of Accounting Research Bulletin No. 43 to the extent the paragraphs indicated specify a particular treatment within income or retained earnings.

3. This Opinion (a) concludes that net income should reflect all items of profit and loss recognized during the period except for prior period adjustments, with extraordinary items to be shown separately as an element of net income of the period, (b) specifies the criteria to be used in determining which items, if any, recognized during the current period are to be considered extraordinary items, (c) specifies the criteria to be used in determining which items, if any, recognized during the current period are to be considered prior period adjustments and excluded from net income for the current period and (d) specifies the statement format and terminology to be used and the disclosures to be made when extraordinary items or prior period adjustments are present.

4. This Opinion also specifies the method of treating extraordinary items and prior period adjustments in comparative

statements for two or more periods, specifies the disclosures required when previously issued statements of income are restated and recommends methods of presentation of historical, statistical-type financial summaries which include extraordinary items or are affected by prior period adjustments. In Part II, this Opinion specifies how earnings per share and dividends per share should be computed and reported.

5. For convenience, the term *net income* is used herein to refer to either net income or net loss. Similarly, *net income per share* or *earnings per share* is used to refer to either net income (or earnings) per share or net loss per share.

Applicability

6. This Opinion applies to general purpose statements which purport to present results of operations in conformity with generally accepted accounting principles. Investment companies, insurance companies and certain nonprofit organizations have developed income statements with formats different from those of the typical commercial entity described herein, designed to highlight the peculiar nature and sources of their income or operating results. The portion of this Opinion which requires that net income be presented as one amount does not apply to such entities. A committee of the American Institute of Certified Public Accountants is in the process of recommending a format for the income statement of commercial banks. Until such recommendation has been given and until the Board has taken a position thereon, this Opinion is not applicable to commercial banks.

I—NET INCOME AND THE TREATMENT OF EXTRAORDINARY ITEMS AND PRIOR PERIOD ADJUSTMENTS

DISCUSSION

General

7. Business entities have developed a reporting pattern under which periodic financial statements are prepared from their accounting records to reflect the financial position of the entity at a particular date and the financial results of its activities for a specified period or periods. The statement of income and the statement of retained earnings (separately or combined) are designed to reflect, in a broad sense, the "results of operations."

8. A problem in reporting the results of operations of a business entity for one or more periods is the treatment of extraordinary items and prior period adjustments. This Opinion discusses the nature of events and transactions which might be considered "extraordinary," establishes related criteria which the Board feels are reasonable and practicable, and specifies the method and extent of disclosure of such items in the financial statements. The Opinion also discusses the various types of adjustment which might be considered to be proper adjustments of the recorded results of operations of prior periods and establishes criteria which the Board feels are reasonable and practicable for the relatively few items which should be so recognized.

Historical background

General

9. There is considerable diversity of views as to whether extraordinary items and prior period adjustments should enter into the determination of net income of the period in which they are recognized. When Accounting Research Bulletin No. 32 was issued in December 1947, as well as when it was reissued in June 1953 as Chapter 8 of Accounting Research Bulletin No. 43, two conflicting viewpoints had attracted considerable support. The paragraphs which follow summarize the discussion of these two viewpoints contained in Chapter 8.

Current operating performance

10. Under one viewpoint, designated *current operating performance,* the principal emphasis is upon the ordinary, normal, recurring operations of the entity during the current period. If extraordinary or prior period transactions have occurred, their inclusion might impair the significance of net income to such an extent that misleading inferences might be drawn from the amount so designated.

11. Advocates of this position believe that users of financial statements attach a particular business significance to the statement of income and the "net income" reported therein. They point out that, while some users are able to analyze a statement of income and to eliminate from it those prior period adjustments and extraordinary items which may tend to impair its usefulness for their purposes, many users are not trained to do this. They believe that management (subject to the attestation of the independent auditors) is in a better position to do this, and to eliminate the effect of such items from the amount designated as net income.

12. Advocates of this position also point out that many companies, in order to give more useful information concerning their earnings performance, restate the earnings or losses of affected periods to reflect the proper allocation of prior period adjustments. They believe therefore that items of this type may best be handled as direct adjustments of retained earnings or as "special items" excluded from net income of the current period. They feel that extraordinary items of *all* types may often best be disclosed as direct adjustments of retained earnings, since this eliminates any distortive effect on reported earnings.

All inclusive

13. Under the other viewpoint, designated *all inclusive,* net income is presumed to include all transactions affecting the net increase or decrease in proprietorship equity during the current period, except dividend distributions and transactions of a capital nature.

14. Proponents of this position believe that the aggregate of such periodic net incomes, over the life of an enterprise, constitutes total net income, and that this is the only fair and complete method of reporting the results of operations of the entity. They believe that extraordinary items and prior period adjustments are part of the earnings history of an entity and that omission of such items from periodic statements of income increases the possibility that these items will be overlooked in a review of operating results for a period of years. They also stress the dangers of possible manipulation of annual earnings figures if such items may be omitted from the determination of net income. They believe that a statement of income including all such items is easy to understand and less subject to variations resulting from different judgments. They feel that, when judgment is allowed to determine whether to include or exclude particular items or adjustments, significant differences develop in the treatment of borderline cases and that there is a danger that the use of "extraordinary" as a criterion may be a means of equalizing income. Advocates of this theory believe that full disclosure in the income statement of the nature of any extraordinary items or prior period adjustments during each period will enable the user of a statement of income to make his own assessment of the importance of the items and their effects on operating results.

Decisions of committee on accounting procedure—subsequent developments

15. The committtee on accounting procedure (predecessor of the Accounting Principles Board) did not embrace either of these viewpoints in its entirety in issuing its first Accounting Research Bulletin on this subject in December 1947. Instead, the committee stated "... it is the opinion of the committee that there should be a general presumption that all items of profit and loss recognized during the period are to be used in determining the figure reported as net income. The only possible exception to this presumption in any case would be with respect to items which in the aggregate are materially significant in relation to the company's net income and are clearly not identi-

fiable with or do not result from the usual or typical business operations of the period. Thus, only extraordinary items such as the following may be excluded from the determination of net income for the year, and they should be excluded when their inclusion would impair the significance of net income so that misleading inferences might be drawn therefrom: . . . :"[1] The list of items which followed consisted of material charges or credits, other than ordinary adjustments of a recurring nature, (a) specifically related to operations of prior years, (b) resulting from unusual sales of assets not acquired for resale and not of the type in which the company usually deals, (c) resulting from losses of a type not usually insured against, (d) resulting from the write-off of a material amount of intangibles or a material amount of unamortized bond discount or premium and expense. The language quoted above was continued substantially unchanged in the 1953 *Restatement and Revision of Accounting Research Bulletins,* becoming Chapter 8 of ARB No. 43.

16. Since the issuance of these guidelines for the determination of net income, developments in the business and investment environment have increased the emphasis on, and interest in, the financial reporting format of business entities and the nature of the amount shown as net income therein. As a result of the widespread and increasing dissemination of financial data, often in highly condensed form, to investors and potential investors, suggestions have been made that the criteria for the determination of the amount to be reported as net income, insofar as it is affected by extraordinary items and prior period adjustments, should be re-examined.

OPINION

Summary

17. The Board has considered various methods of reporting the effects of extraordinary events and transactions and of prior period adjustments which are recorded in the accounts during a particular accounting period. The Board has concluded that net income should reflect all items of profit and loss recognized

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[1] Accounting Research Bulletin No. 32, *Income and Earned Surplus.*

during the period with the sole exception of the prior period adjustments described below. *Extraordinary items* should, however, be segregated from the results of ordinary operations and shown separately in the income statement, with disclosure of the nature and amounts thereof. The criteria for determination of extraordinary items are described in paragraph 21 below.

18. With respect to *prior period adjustments,* the Board has concluded that those rare items which relate directly to the operations of a specific prior period or periods, which are material and which qualify under the criteria described in paragraphs 23 and 25 below should, in single period statements, be reflected as adjustments of the opening balance of retained earnings. When comparative statements are presented, corresponding adjustments should be made of the amounts of net income (and the components thereof) and retained earnings balances (as well as of other affected balances) for all of the periods reported therein, to reflect the retroactive application of the prior period adjustments. (See paragraph 26 for required disclosures of prior period adjustments.)

19. The Board has concluded that the above approach to the reporting of the results of operations of business entities will result in the most meaningful and useful type of financial presentation. The principal advantages are: (a) inclusion of all operating items related to the current period, with segregation and disclosure of the extraordinary items, (b) a reporting of current income from operations free from distortions resulting from material items directly related to prior periods and (c) proper retroactive reflection in comparative financial statements of material adjustments relating directly to prior periods. In reaching its conclusion, the Board recognizes that this approach may involve (a) occasional revision of previously-reported net income for prior periods to reflect subsequently recorded material items directly related thereto, (b) difficulty in segregating extraordinary items and items related to prior periods and (c) the possibility that disclosures regarding adjustments of opening balances in retained earnings or of net income of prior periods will be overlooked by the reader.

Income statement presentation

20. Under this approach, the income statement should disclose the following elements:

Income before extraordinary items
Extraordinary items
(less applicable income tax)
Net income

If the extraordinary items are few in number, descriptive captions may replace the caption *extraordinary items* and related notes. In such cases, the first and last captions shown above should nonetheless appear. Similarly, even though material extraordinary items may net to an immaterial amount, they should be positioned and disclosed as indicated above, and the first and last captions shown above should appear. If there are no extraordinary items, the caption *net income* should replace the three captions shown above. The amount of income tax applicable to the segregated items should be disclosed, either on the face of the income statement or in a note thereto. (The amount of prior period adjustments and the amount of income tax applicable thereto should also be disclosed, as outlined in paragraph 26.) Illustrative examples of the treatment of such items in financial statements appear herein as Exhibits A through D.

Criteria for extraordinary items related to the current period

21. The segregation in the income statement of the effects of events and transactions which have occurred during the current period, which are of an extraordinary nature and whose effects are material requires the exercise of judgment. (In determining materiality, items of a similar nature should be considered in the aggregate. Dissimilar items should be considered individually; however, if they are few in number, they should be considered in the aggregate.) Such events and transactions are identified primarily by the nature of the underlying occurrence. They will be of a character significantly different from the typical or customary business activities of the entity. Accordingly, they will be events and transactions of material effect which would not be expected to recur frequently and which would not be considered as recurring factors in any evaluation of the ordinary operating

processes of the business. Examples of extraordinary items, assuming that each case qualifies under the criteria outlined above, include material gains or losses (or provisions for losses) from (a) the sale or abandonment of a plant or a significant segment of the business,[2] (b) the sale of an investment not acquired for resale, (c) the write-off of goodwill due to unusual events or developments within the period, (d) the condemnation or expropriation of properties and (e) a major devaluation of a foreign currency. As indicated above, such material items, less applicable income tax effect, should be segregated, but reflected in the determination of net income.

22. Certain gains or losses (or provisions for losses), regardless of size, do not constitute extraordinary items (or prior period adjustments) because they are of a character typical of the customary business activities of the entity. Examples include (a) write-downs of receivables, inventories and research and development costs, (b) adjustments of accrued contract prices and (c) gains or losses from fluctuations of foreign exchange. The effects of items of this nature should be reflected in the determination of income before extraordinary items. If such effects are material, disclosure is recommended.

Criteria for prior period adjustments

23. Adjustments related to prior periods — and thus excluded in the determination of net income for the current period — are limited to those material adjustments which (a) can be specifically identified with and directly related to the business activities of particular prior periods, and (b) are not attributable to economic events occurring subsequent to the date of the financial statements for the prior period, and (c) depend primarily on determinations by persons other than management and (d) were not susceptible of reasonable estimation prior to such determination. Such adjustments are rare in modern financial accounting. They relate to events or transactions which occurred in a prior period, the accounting effects of which could not be determined with reasonable assurance at that time, usually because of some major uncertainty then existing. Evidence

[2] Operating results prior to the decision as to sale or abandonment should not be considered an element of the extraordinary gain or loss.

of such an uncertainty would be disclosure thereof in the financial statements of the applicable period, or of an intervening period in those cases in which the uncertainty became apparent during a subsequent period. Further, it would be expected that, in most cases, the opinion of the reporting independent auditor on such prior period would have contained a qualification because of the uncertainty. Examples are material, nonrecurring adjustments or settlements of income taxes, of renegotiation proceedings or of utility revenue under rate processes. Settlements of significant amounts resulting from litigation or similar claims may also constitute prior period adjustments.

24. Treatment as prior period adjustments should not be applied to the normal, recurring corrections and adjustments which are the natural result of the use of estimates inherent in the accounting process. For example, changes in the estimated remaining lives of fixed assets affect the computed amounts of depreciation, but these changes should be considered prospective in nature and not prior period adjustments. Similarly, relatively immaterial adjustments of provisions for liabilities (including income taxes) made in prior periods should be considered recurring items to be reflected in operations of the current period. Some uncertainties, for example those relating to the realization of assets (collectibility of accounts receivable, ultimate recovery of deferred costs or realizability of inventories or other assets), would not qualify for prior period adjustment treatment, since economic events subsequent to the date of the financial statements must of necessity enter into the elimination of any previously-existing uncertainty. Therefore, the effects of such matters are considered to be elements in the determination of net income for the period in which the uncertainty is eliminated. Thus, the Board believes that prior period adjustments will be rare.

25. A change in the application of accounting principles may create a situation in which retroactive application is appropriate. In such situations, these changes should receive the same treatment as that for prior period adjustments. Examples are changes in the basis of preparing consolidated financial statements or in the basis of carrying investments in subsidiaries (e.g., from cost to the equity method).

Disclosure of prior period adjustments and restatements of reported net income

26. When prior period adjustments are recorded, the resulting effects (both gross and net of applicable income tax) on the net income of prior periods should be disclosed in the annual report for the year in which the adjustments are made.[3] When financial statements for a single period only are presented, this disclosure should indicate the effects of such restatement on the balance of retained earnings at the beginning of the period and on the net income of the immediately preceding period. When financial statements for more than one period are presented, which is ordinarily the preferable procedure,[4] the disclosure should include the effects for each of the periods included in the statements. Such disclosures should include the amounts of income tax applicable to the prior period adjustments. Disclosure of restatements in annual reports issued subsequent to the first such post-revision disclosure would ordinarily not be required.

Historical summaries of financial data

27. It has become customary for business entities to present historical, statistical-type summaries of financial data for a number of periods — commonly five or ten years. The Board recommends that the format for reporting extraordinary items described in paragraph 20 be used in such summaries. The Board further recommends that, whenever prior period adjustments have been recorded during any of the periods included therein, the reported amounts of net income (and the components thereof), as well as other affected items, be appropriately restated, with disclosure in the first summary published after the adjustments.

Capital transactions

28. The Board reaffirms the conclusion of the former committee on accounting procedure that the following should be

[3] The Board recommends disclosure, in addition, in interim reports issued during that year subsequent to the date of recording the adjustments.

[4] See ARB No. 43, Chapter 2A, *Form of Statements — Comparative Financial Statements.*

excluded from the determination of net income or the results of operations under all circumstances: (a) adjustments or charges or credits resulting from transactions in the company's own capital stock,[5] (b) transfers to and from accounts properly designated as appropriated retained earnings (such as general purpose contingency reserves or provisions for replacement costs of fixed assets) and (c) adjustments made pursuant to a quasi-reorganization.

Illustrative statements

29. Examples of financial statements illustrating applications of the Board's conclusions appear as Exhibits to this Opinion. The illustrative income statements are prepared in "single-step" form. The "multi-step" form is also acceptable. Regardless of the form used, the income statement should disclose revenues (sales), and the elements mentioned in paragraph 20 above should be clearly disclosed in the order there indicated.

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[5] See paragraph 12 of APB Opinion No. 6, *Status of Accounting Research Bulletins.*

II—COMPUTATION AND REPORTING OF EARNINGS PER SHARE

Introduction

30. Statistical presentations of periodic "net income per share," "net loss per share" or "earnings per share" are commonly used in prospectuses, proxy material and annual reports to stockholders, and in the compilation of business earnings data for the press, statistical services and other publications.[6] When presented in conjunction with formal financial statements for a number of periods, such information can be useful, together with other data, in evaluating the past operating performance of a business entity and attempting to form an opinion as to its future potential.

OPINION

General

31. The Board believes that earnings per share data are most useful when furnished in conjunction with a statement of income. Accordingly, the Board strongly recommends that earnings per share be disclosed in the statement of income.

32. It is the Board's opinion that the reporting of per share data should disclose amounts for (a) income before extraordinary items, (b) extraordinary items, if any, (less applicable income tax) and (c) net income – the total of (a) and (b). (See paragraph 20 – Part I.) The Board believes that not only will this reporting format increase the usefulness of the reports of results of operations of business entities, but that it will also help to eliminate the tendency of many users to place undue emphasis on one amount reported as earnings per share. Illustrative examples of various methods of disclosure of per share data are included in Exhibits A to E herein.

Computations for single periods

General

33. When used without qualification, *earnings per share* refers to the amount of earnings applicable to each share of

[6] See Paragraph 5.

common stock or other residual security outstanding.[7] When more than one class of common stock is outstanding, or when an outstanding security has participating dividend rights with the common stock, or when an outstanding security clearly derives a major portion of its value from its conversion rights or its common stock characteristics, such securities should be considered "residual securities" and not "senior securities" for purposes of computing earnings per share. Appropriate consideration should be given to any senior dividend rights or interest relating to such securities, and to any participation provisions. (See also paragraph 49.) In order to compute earnings per share properly, consideration should be given to shares outstanding which are senior to the common stock, and to changes in the common and senior shares during the period. Procedures for doing so are outlined below. The term *common,* when used in this and subsequent paragraphs, includes "residual securities" as defined above.

Treatment of senior shares outstanding

34. The term *earnings per share* should not be used with respect to outstanding shares of senior securities (e.g., preferred stock) in view of their limited dividend rights. In such cases it is often informative to show the number of times or the extent to which the dividend requirements of senior securities have been earned ("earnings coverage"), but such information should not be designated as earnings per share.

35. The claims of senior shares on earnings should be deducted from net income (and also from income before extraordinary items, if an amount therefor appears in the statement) before computing per share amounts applicable to residual securities. Therefore, in arriving at earnings applicable to common stock, provision should be made for cumulative preferred dividends for the period, whether or not earned. (In the case of a net loss, the amount of the loss should be increased by any cumulative preferred dividends for the period.) When cumula-

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7 When, as occasionally occurs in business combinations, an agreement exists to issue additional shares at a future date without additional consideration and without other significant conditions precedent (such as the attainment of specified levels of earnings), such shares are normally reflected in the balance sheet. These shares should be considered as outstanding for purposes of computing per share earnings data.

tive preferred dividends are in arrears, the per share and aggregate amounts thereof should be disclosed. When preferred dividends are cumulative only if earned, no adjustment of this type is required, except to the extent of income available therefor. When preferred dividends are in no way cumulative, only the amount of such dividends declared during the period should be deducted. In all cases, the effect that has been given to dividend rights of senior securities in arriving at the earnings per share of residual securities should be disclosed.

Changes in common or senior shares during the period

36. The computation of earnings per share should be based on the weighted average number of shares outstanding during the period. Minor increases and decreases in the number of common shares outstanding during the period may be disregarded; under these conditions, the computation may be based on the number of common shares outstanding at the end of the period. For purposes of determining the number of shares outstanding, reacquired shares (including treasury stock) should be excluded. Major increases or decreases should be taken into consideration as discussed below.

37. When common shares are issued to acquire a business in a transaction which is accounted for as a purchase, the computation should be based on a weighted average of the shares outstanding during the period. When a business combination is accounted for as a pooling of interests, the computation should be based on the aggregate of the weighted average outstanding shares of the constituent businesses (adjusted to equivalent shares of the surviving business) determined in accordance with the provisions herein. This difference in treatment reflects the fact that, in a purchase, the results of operations of the acquired business are included in the statement of income only from the date of acquisition; whereas, in a pooling of interests, the results of operations are combined for the entire period. In the case of reorganizations, the computations should be based on an analysis of the particular transaction according to the criteria contained herein.

38. When senior stock or debt is converted into common stock during a period, earnings per share should be based on a

weighted average of the number of shares outstanding during the period. Use of a weighted average makes unnecessary any adjustments with respect to interest or other related factors. Dividends on preferred stock applicable to the period prior to conversion should be handled in accordance with paragraph 35 above. Supplementary pro forma computations of earnings per share, showing what the earnings would have been if the conversion had taken place at the beginning of the period, should be furnished if the effect of conversion is material, as outlined in paragraph 41 below.

39. When the number of shares outstanding increases as a result of a stock dividend or stock split,[8] or decreases as a result of a reverse split, without significant proceeds or disbursements, the computation should give retroactive recognition to an appropriate equivalent change in capital structure for the entire period. When a decrease in the number of shares outstanding results from acquisition of treasury stock or from a transaction other than a reverse split, the computation should be based on a weighted average of the number of shares outstanding during the period.

Changes in common or senior shares after close of period

40. When changes in common stock due to stock splits or reverse splits take place after the close of the period but before completion and issuance of the financial report, the per share computations should be based on the new number of shares, on a pro forma basis, since the reader's primary interest is presumed to be related to the current capitalization. Similar considerations apply to stock dividends, although a relatively small stock dividend may be disregarded. When per share computations reflect changes in the number of shares after the close of the period, this fact should be disclosed. It is usually not satisfactory to show two amounts of earnings per share under these circumstances.

41. When senior stock or debt is converted into common stock after the close of the period but before completion and issuance

[8] See ARB No. 43, Chapter 7B, *Capital Accounts — Stock Dividends and Stock Split-Ups.*

of the financial report, supplementary pro forma computations of earnings per share, showing what the earnings would have been if the conversion had taken place at the beginning of the latest period, should be furnished if the effect is material. In making these computations, dividends paid on the senior securities converted should not be deducted from the historical net income for the period; interest and related expenses on the debt converted, less applicable income tax, should be added to the historical net income of the period. The bases of these supplementary computations should be disclosed.

42. Occasionally a sale of common stock for cash is scheduled to occur after the close of the period but before completion and issuance of the financial report. When a portion or all of the proceeds of the sale are to be used to retire preferred stock or debt, supplementary pro forma computations of earnings per share should be furnished to show what the earnings would have been for the latest period if the retirement had taken place at the beginning of that period, if the effect is material. The average number of shares outstanding to be used in the computation should include those whose proceeds are to be used to retire the preferred stock or debt. The basis of these supplementary computations should be disclosed.

Contingent changes and dilution[9]

43. Under certain circumstances, earnings per share may be subject to dilution in the future if existing contingencies permitting issuance of common shares eventuate. Such circumstances include contingent changes resulting from the existence of (a) outstanding senior stock or debt which is convertible into common shares, (b) outstanding stock options, warrants or similar agreements and (c) agreements for the issuance of common shares for little or no consideration upon the satisfaction of certain conditions (e.g., the attainment of specified levels of earnings following a business combination). If such potential dilution is material, supplementary pro forma computations of earnings per share should be furnished, showing what the earnings would be if the conversions or contingent issuances took place. The

[9] Paragraphs 43 and 44 do not apply to securities which, because of their characteristics, are accorded the treatments described in paragraph 33 or in note 7 thereto.

Board strongly recommends that such per share data be disclosed in the statement of income. The methods of computation should follow those outlined in the preceding paragraphs. When increased earnings levels are a condition of issuance, as in (c) above, such earnings should be given appropriate recognition in the computation of potential dilution. (See also paragraph 49.)

44. The fact that the relationship between current market and conversion prices makes conversion or other contingent issuance unlikely in the foreseeable future is not sufficient basis for omission of the disclosure of the pro forma earnings per share data described in paragraph 43. Disclosure of the current conditions would, nonetheless, normally be desirable.

Computations for two or more periods (including historical, statistical-type summaries in annual reports to stockholders)

45. The criteria governing the computations of earnings per share for two or more periods, while generally conforming with those outlined above for single periods, vary somewhat depending on the nature and purpose of the presentation in which they appear. Variations in the capitalization structure of the entity during the periods may have substantial effects on earnings per share, and comparisons of such data without adequate explanations may tend to be misleading. Furthermore, unless such earnings statistics are presented in conjunction with financial statements and with other historical information, the usefulness of per share data in evaluating the past operating performance of a business entity and attempting to form an opinion as to its future potential is limited.

46. Annual reports to stockholders are generally considered to be primarily historical in nature. Thus, although a trend has developed in recent years to include statistical-type summaries of financial data for a number of years, the main emphasis in the financial statements themselves has been on the results of the broad business activities of the entity during the current year as compared with those of the immediately preceding year. Accordingly, the computations of earnings per share in annual reports to stockholders, whether related to the formal financial

statements in comparative form for two years or to the historical summaries covering a period of years, should usually be based on the capitalization structure existing during each period. The computation for each year should therefore follow the criteria outlined in paragraphs 33 through 44 above. The principal exception to this practice of avoiding retroactive recomputations for changes in the capitalization structure occurs when a pooling of interests has occurred. Since the earnings of the pooled entities are combined for all periods, the capital structure used to compute earnings per share for all periods should reflect appropriate recognition of the securities issued in the pooling transaction. Other exceptions to this treatment are the result of (a) stock splits or reverse splits, and (b) stock dividends, including those in recurring small percentages which in the aggregate become material during the periods involved. In these situations the methods outlined in paragraphs 39 and 40 above should be followed for all of the periods involved. When changes in the capitalization structure of the types described in paragraphs 41 and 42 above occur after the close of the last period, or when contingencies exist (see paragraphs 43 and 44), supplementary pro forma computations for the latest period, as a minimum, should be furnished.

47. In those cases in which net income of a prior period has been restated as a result of a prior period adjustment during the current period, any earnings per share data should be based on the restated amount of net income. The effect of the restatement, expressed in per share terms, should be disclosed.

48. The Board recommends that management be guided by the methods outlined in paragraphs 45, 46 and 47 herein for computing and reporting earnings per share in historical, statistical-type summaries contained in annual reports to stockholders.

Other

49. The Board recognizes that it is impracticable, in this Opinion, to discuss all the possible conditions and circumstances under which it may be necessary or desirable to compute earnings per share. However, when situations not expressly covered in this Opinion occur, they should be dealt with in accordance

with the guidelines and criteria outlined herein. Such determinations require careful consideration of all the facts, and the exercise of judgment. The resulting earnings per share data should reflect a realistic evaluation of all the attendant circumstances. In all unusual cases, the basis of the computations should be disclosed.

Dividends per share

50. Dividends constitute historical facts and usually are so reported. However, in certain cases, such as those affected by stock dividends or splits or reverse splits, the presentation of dividends per share should be made in terms of the current equivalent of the number of shares outstanding at the time of the dividend, so that dividends per share and earnings per share will be stated on a comparable basis. A disclosure problem exists in presenting data as to dividends per share following a pooling of interests. If the dividend policies of the constituent companies were different, a combination of dividends declared may be misleading, even though the per share data are expressed in shares of the continuing company. In such cases, it is usually preferable to disclose the dividends declared per share by the principal constituent and to disclose, in addition, either the amount per equivalent share or the total amount for each period for the other constituent, with appropriate explanations of the circumstances. When dividends per share are presented on other than an historical basis, the basis of presentation should be disclosed.

Illustrative Statements

51. Examples illustrating the inclusion of per share data in financial statements in accordance with the Board's recommendations are shown in Exhibits A, B, D and E.

EFFECTIVE DATE

52. This Opinion shall be effective for fiscal periods beginning after December 31, 1966. However, where feasible the Board recommends earlier compliance with this Opinion. The Board also strongly recommends that, in comparative statements in which one or more periods are subject to this Opinion, the provisions of the Opinion be applied to all periods appearing therein.

The Opinion entitled "Reporting the Results of Operations" was adopted unanimously by the twenty members of the Board, of whom five, Messrs. Biegler, Catlett, Frese, Halvorson and Walker, assented with qualification.

Mr. Biegler assents to the issuance of this Opinion because he believes that the usefulness of the income statement to the investor is enhanced when all items of profit and loss relating to the period are included in the determination of net income and the results of the ordinary, recurring operations of a business are reported separately from extraordinary items. He believes that the caption described in paragraph 20 as "Income before extraordinary items" can best meet the needs of investors for an index of the results of and trends in ordinary recurring operations when there is excluded therefrom those gains or losses which are extraordinary because of the combination of rarity in the circumstances giving rise thereto and the abnormal size thereof. Accordingly, he dissents from the conclusion stated in paragraph 22 that certain types of gains or losses, *regardless of size,* must be reflected in the determination of "income before extraordinary items." He believes that the quality of being extraordinary can be derived from rarity or extreme infrequency in size, as well as from the nature of a transaction or event.

Mr. Catlett does not agree that the criteria for prior period adjustments as set forth in paragraphs 23 and 24 of this Opinion are established on a proper basis. He considers that the nature of the adjustment and the factors which cause it are controlling, and that any material item which is in fact applicable to, and a correction of, a prior period should be accounted for as an adjustment of that period. He believes that there are cases in which prior period adjustments are appropriate with respect to questions involving realization of assets, such as receivables, inventories and property. He is of the opinion (1) that the Board is establishing arbitrary rules to discourage or prohibit prior period adjustments rather than determining appropriate principles to be followed in reviewing the nature of the items involved, and (2) that the inclusion in the current period's net income of a material item which is really applicable to a prior period results in the financial statements for two periods being in error.

Mr. Walker, joined by Mr. Frese, recognizes that the Opinion attempts to set up the criteria to restrict the number of items deemed to be prior period adjustments which are to be excluded from net income of the year and thrown back to prior years by restating opening balances of retained earnings. He nevertheless feels that such treatment will result in continuing controversy and will be confusing to users of financial statements. He believes that such treatment should not be mandatory, but rather should be left to the judgment of the managements who have the primary responsibility for proper presentation to stockholders. He therefore recommends that the so-called "all inclusive" statement of income — consistently followed — and with adequate disclosure of material special items (including extraordinary and prior period items) should be permissive.

Mr. Halvorson concurs in the qualified assent expressed by Mr. Walker in respect of the mandatory exclusion of prior period adjustments from the current statement of income, and extends his qualification to the mandatory determination of an arbitrary "income before extraordinary items" within the determination of net income.

NOTES

Opinions present the considered opinion of at least two-thirds of the members of the Accounting Principles Board, reached on a formal vote after examination of the subject matter.

Except as indicated in the succeeding paragraph, the authority of the Opinions rests upon their general acceptability. While it is recognized that general rules may be subject to exception, the burden of justifying departures from Board Opinions must be assumed by those who adopt other practices.

Action of Council of the Institute (Special Bulletin, Disclosure of Departures From Opinions of Accounting Principles Board, *October 1964) provides that:*

a. "Generally accepted accounting principles" are those principles which have substantial authoritative support.

b. Opinions of the Accounting Principles Board constitute "substantial authoritative support."

c. "Substantial authoritative support" can exist for accounting principles that differ from Opinions of the Accounting Principles Board.

The Council action also requires that departures from Board Opinions be disclosed in footnotes to the financial statements or in independent auditors' reports when the effect of the departure on the financial statements is material.

Unless otherwise stated, Opinions of the Board are not intended to be retroactive. They are not intended to be applicable to immaterial items.

Accounting Principles Board (1966-1967)

Clifford V. Heimbucher
Chairman
Marshall S. Armstrong
Donald J. Bevis
John C. Biegler
George R. Catlett
W. A. Crichley
Joseph P. Cummings
Sidney Davidson
Philip L. Defliese
Walter F. Frese
Newman T. Halvorson
LeRoy Layton
Oral L. Luper
John K. McClare
Robert J. Murphey
Louis H. Penney
John W. Queenan
Wilbert A. Walker
Frank T. Weston
Robert E. Witschey

EXHIBITS

ILLUSTRATIVE STATEMENTS

The following examples illustrate the treatment of extraordinary items and prior period adjustments in financial statements. The format of the statements is illustrative only, and does not necessarily reflect a preference by the Accounting Principles Board for the format or for the intermediate captions shown. See Part I – paragraph 20 as to certain final captions. The statements do not include customary disclosures, such as the amount of depreciation expense for the period, which are not considered pertinent to the subject matter of this Opinion.

The illustrative examples, in comparative form, are as follows:

	Exhibit
Statement of Income and Retained Earnings	A
Statement of Income	B
Statement of Retained Earnings	C
Statement of Income – Five Years	D
Disclosures of per share data when senior securities are outstanding or material potential dilution exists	E

EXHIBIT A

STATEMENT OF INCOME AND RETAINED EARNINGS

Years Ended December 31, 1967 and December 31, 1966

	1967	1966 (Note 2)
Net sales	$84,580,000	$75,650,000
Other income	80,000	100,000
	84,660,000	75,750,000
Cost and expenses –		
Cost of goods sold	60,000,000	55,600,000
Selling, general and administrative expenses	5,000,000	4,600,000
Interest expense	100,000	100,000
Other deductions	80,000	90,000
Income tax	9,350,000	7,370,000
	74,530,000	67,760,000
Income before extraordinary items	10,130,000	7,990,000
Extraordinary items, net of applicable income tax of $1,880,000 in 1967 (Note 1)	(2,040,000)	(1,280,000)
Net Income	8,090,000	6,710,000
Retained earnings at beginning of year –		
As previously reported	28,840,000	25,110,000
Adjustments (Note 2)	(3,160,000)	(1,760,000)
As restated	25,680,000	23,350,000
	33,770,000	30,060,000
Cash dividends on common stock – $.75 per share	4,380,000	4,380,000
Retained earnings at end of year	$29,390,000	$25,680,000
Per share of common stock –		
Income before extraordinary items	$1.73	$1.37
Extraordinary items, net of tax	(.34)	(.22)
Net income	$1.39	$1.15

Note 1

During 1967 the Company sold one of its plants at a net loss of $2,040,000, after applicable income tax reduction of $1,880,000. During 1966 the Company sold an investment in marketable securities at a loss of $1,280,000, with no income tax effect.

Note 2

The balance of retained earnings at December 31, 1966 has been restated from amounts previously reported to reflect a retroactive charge of $3,160,000 for additional income taxes settled in 1967. Of this amount, $1,400,000 ($.24 per share) is applicable to 1966 and has been reflected as an increase in tax expense for that year, the balance (applicable to years prior to 1966) being charged to retained earnings at January 1, 1966.

EXHIBIT B

STATEMENT OF INCOME

Years Ended December 31, 1967 and December 31, 1966

	1967	1966 (Note 2)
Net sales	$84,580,000	$75,650,000
Other income	80,000	100,000
	84,660,000	75,750,000
Cost and expenses –		
Cost of goods sold	60,000,000	55,600,000
Selling, general and administrative expenses	5,000,000	4,600,000
Interest expense	100,000	100,000
Other deductions	80,000	90,000
Income tax	9,350,000	7,370,000
	74,530,000	67,760,000
Income before extraordinary items (per share: 1967 – $1.73; 1966 – $1.37)	10,130,000	7,990,000
Extraordinary items, less applicable income tax in 1967 (Note 1) (per share: 1967 – $(.34); 1966 – $(.22)).	(2,040,000)	(1,280,000)
Net income (per share: 1967 – $1.39; 1966 – $1.15)	$ 8,090,000	$ 6,710,000

Note 1

During 1967 the Company sold one of its plants at a net loss of $2,040,000, after applicable income tax reduction of $1,880,000. During 1966 the Company sold an investment in marketable securities at a loss of $1,280,000, with no income tax effect.

Note 2

The balance of retained earnings at December 31, 1966 has been restated from amounts previously reported to reflect a retroactive charge of $3,160,000 for additional income taxes settled in 1967. Of this amount, $1,400,000 ($.24 per share) is applicable to 1966 and has been reflected as an increase in tax expense for that year, the balance (applicable to years prior to 1966) being charged to retained earnings at January 1, 1966.

EXHIBIT C

STATEMENT OF RETAINED EARNINGS

Years Ended December 31, 1967 and December 31, 1966

	1967	1966
Retained earnings at beginning of year –		
As previously reported	$28,840,000	$25,110,000
Adjustments (Note 2)	(3,160,000)	(1,760,000)
As restated	25,680,000	23,350,000
Net income	8,090,000	6,710,000
	33,770,000	30,060,000
Cash dividends on common stock –		
$.75 per share	4,380,000	4,380,000
Retained earnings at end of year	$29,390,000	$25,680,000

(See accompanying notes appearing on statement of income, Exhibit B.)

EXHIBIT D

STATEMENT OF INCOME

For the Five Years Ended December 31, 1967

	1963	1964	1965	1966	1967
	(In thousands of dollars)				
Net sales	$67,100	$66,700	$69,300	$75,650	$84,580
Other income	80	80	60	100	80
	67,180	66,780	69,360	75,750	84,660
Costs and expenses:					
Cost of goods sold	48,000	47,600	49,740	55,600	60,000
Selling, general and administrative expenses	4,300	4,200	4,500	4,600	5,000
Interest expense	120	100	90	100	100
Other deductions	80	80	60	90	80
Income tax	7,340	7,400	7,490	7,370	9,350
	59,840	59,380	61,880	67,760	74,530
Income before extraordinary items	7,340	7,400	7,480	7,990	10,130
Extraordinary items, net of applicable income tax (Note A)	—	760	—	(1,280)	(2,040)
Net income (Note B)	$ 7,340	$ 8,160	$ 7,480	$ 6,710	$ 8,090

Per share of common stock:					
Income before extraordinary items	$1.26	$1.27	$1.28	$1.37	$1.73
Extraordinary items, net of income tax	—	$ .12	—	$(.22)	$(.34)
Net income	$1.26	$1.39	$1.28	$1.15	$1.39

NOTE A

The extraordinary items consist of the following: 1964 – gain as a result of condemnation of idle land, less applicable income tax of $254,000; 1966 – loss on sale of investment in marketable securities, with no income tax effect; 1967 – loss on sale of plant, less applicable income tax reduction $1,880,000.

NOTE B

The amounts of net income for 1963, 1964 and 1966 have been restated from amounts previously reported to reflect additional income taxes for such years settled in 1967. These retroactive adjustments reduced net income for such years by $860,000 ($.15 per share), $900,000 ($.15 per share) and $1,400,000 ($.24 per share), respectively, as follows:

	1963	1964	1966
	(In thousands of dollars)		
Previously reported	$8,200	$9,060	$8,110
Adjustments	860	900	1,400
As adjusted	$7,340	$8,160	$6,710

EXHIBIT E

DISCLOSURES OF PER SHARE DATA WHEN SENIOR SECURITIES ARE OUTSTANDING OR MATERIAL POTENTIAL DILUTION EXISTS

Senior securities outstanding

When senior securities are outstanding, per share data are preferably shown in the format illustrated in Exhibit A, that is, in a table at the bottom of the income statement and not against the captions of the statement itself. The preferred method is illustrated below:

Per share earnings applicable to common stock (Note X)

Earnings before extraordinary items	$1.23	$ .87
Extraordinary items, net of tax	(.34)	(.22)
Earnings applicable to common stock	$ .89	$ .65

Note X

Per share data are based on the average number of common shares outstanding during each year, after recognition of the dividend requirements ($2,920,000) on the 5% preferred stock.

Material potential dilution exists—convertible preferred stock

Under these conditions, the basic and supplementary per share data are preferably shown at the bottom of the income statement, as in Exhibit A, with an additional note, as follows:

Per share earnings applicable to common stock (Note X)

Earnings before extraordinary items	$1.23	$ .87
Extraordinary items, net of tax	(.34)	(.22)
Earnings applicable to common stock	$ .89	$ .65

Pro forma per share of common stock, reflecting conversion (Note Y)

Income before extraordinary items	$ .99	$ .78
Extraordinary items, net of tax	(.20)	(.12)
Net income	$ .79	$ .66

Note X

Per share data are based on the average number of common shares outstanding during each year, after recognition of the dividend requirements ($2,920,000) on the 5% preferred stock.

Note Y

The pro forma per share data are based on the assumption that the outstanding 5% preferred shares were converted into common shares at the conversion ratio in effect at December 31, 1967, reflecting the 4,380,000 shares issuable on conversion and eliminating the preferred dividend requirements.

Material potential dilution exists — convertible debt, no preferred stock

Under these conditions, the basic and supplementary per share data are preferably shown at the bottom of the income statement, as in Exhibit A, with an additional note, as follows:

Per share of common stock

Income before extraordinary items	$1.73	$1.37
Extraordinary items, net of tax	(.34)	(.22)
Net income	$1.39	$1.15

Pro forma per share of common stock, reflecting conversion (Note M)

Income before extraordinary items	$1.53	$1.21
Extraordinary items, net of tax	(.31)	(.19)
Net income	$1.22	$1.02

Note M

The pro forma per share data are based on the assumption that the 5½% convertible debentures outstanding at December 31, 1967 were converted into common shares at the conversion rate in effect at that date, reflecting the 800,000 shares issuable on conversion and eliminating the related interest on the convertible debentures (less applicable income tax) of $50,000.